

BNDES PROGRAM TO SUPPORT MICRO, SMALL AND MEDIUM-SIZED ENTERPRISES

(BR-0331)

EXECUTIVE SUMMARY

Borrower and executing agency:	National Bank for Economic and Social Development (BNDES)	
Guarantor:	Federative Republic of Brazil	
Amount and source:	IDB (OC):	US\$900 million
	Local counterpart contribution:	US\$900 million
	Total:	US\$1.8 billion
Financial terms and conditions:	Amortization period:	20 years
	Commitment period:	3 years
	Grace period:	4 years
	Disbursement period:	4 years
	Interest rate:	variable
	Inspection and supervision:	1%
	Credit fee:	0.75%
	Currency (OC):	Single Currency Facility
Objectives:	The objective of the program is to support the development and modernization of micro, small and medium-sized enterprises (MSMEs) in Brazil, by providing medium- and long-term financing for investment projects to improve their productivity.	
Description:	<p>The program will consist of a rediscount facility for medium- and long-term loans granted by intermediary financial institutions (IFIs) to Brazilian firms to finance investment projects for the reconversion, improvement and expansion of efficient activities under competitive conditions.</p> <p>All funding under the program would be channeled by the BNDES through already-established second-tier mechanisms that operate through a network of 180 regulated financial agents with more than 15,000 banking branches. Operating policies will be agreed upon by the Bank and BNDES and reflected in the program's Credit Regulations, the main features of which are described in chapter III of this document.</p>	

The Bank's country and sector strategy:

This operation is consistent with the Bank's strategy for the country and sector (document GN-2104-1), which sets five objectives: (i) economic growth with equity; (ii) public sector reform; (iii) improved competitiveness; (iv) alleviation of social problems; and (v) revitalization of regional integration. The proposed operation addresses the objectives described in points (i) and (iii), and is part of the Bank's efforts to promote private productive activities.

The program will supplement the country's efforts to accelerate sustainable economic growth with improved income distribution, since it will support the MSME business segment that has traditionally employs mostly low-income groups, and is currently at a disadvantage in obtaining medium- and long-term financing in comparison with large firms. The program will also permit BNDES to continue to minimize the use of direct and directed credit as a medium- and long-term financing instrument for private investment. The program will have a positive impact as well on the financial system, by facilitating and promoting the expansion of medium- and long-term financing by private commercial banks under market conditions.

Environmental and social review:

A review of BNDES's compliance with environmental standards in similar previous programs indicates that the controls established are functioning satisfactorily and that very few subprojects have had any substantial adverse impact. The Committee on Environment and Social Impact (CESI) reviewed the operation on 25 June 2001, and was satisfied with the technical and institutional mechanisms that BNDES has in place to deal with these issues. Accordingly, the proposed program will continue to use the current environmental control mechanisms and procedures for subprojects financed through IFIs. These include a comprehensive mechanism for controlling the environmental quality of subprojects, based on an audit of compliance with standards of the National Environment Commission (CONAMA) by IFIs and subborrowers alike. The CESI made the following recommendations, which have been fully incorporated into the design of the program: (i) conduct a mid-term environmental review based on a representative sample of subprojects financed; and (ii) include environmental control requirements in the program Credit Regulations.

Benefits:

The processes of market globalization and integration require a number of improvements in financial support for productive activities, particularly with respect to the availability of medium and long-term financing for productive conversion and modernization of Brazilian MSMEs, which constitute a major part of the country's goods and services output. The program will deepen the development of

financial markets by generating medium and long-term resources to finance small and medium-sized enterprises through the commercial banking system. It will also continue to provide support, together with BNDES, for strengthening microenterprises' access to institutional credit, thereby helping them to avoid resort to informal financing which is not only extremely burdensome but operates largely outside the reach of taxation, environmental and other regulations.

Significance is also attached to using institutions of the BNDES type as a means of leveraging the impact of the Bank's activities, particularly in such a problematic area as providing credit for MSMEs; the provision of swift and massive funding to the target group is fully justified in light of the current restrictive credit conditions that are holding back growth of Brazil's productive sector, and the excellent track record that BNDES has achieved in similar previous programs, which had a considerable impact on output and employment.

Risks:

Proper implementation of the proposed program will depend primarily on maintaining a macroeconomic and financial framework appropriate to the growth of private investment. The Brazilian economy has recently suffered a slowdown, but the size of the operation relative to the latent demand for medium and long-term credit suggests that this risk is unlikely to affect the pace of program execution.

Another important risk factor lies in the distortions that exist within the financial system, but this risk has been reduced by the reorganization introduced under the *Real* Plan, which entailed a consolidation of the financial system, the strengthening of regulatory and supervisory mechanisms, and the reorganization or privatization of much of the state banking system. The current situation of the Brazilian financial system is such that resources under the proposed program can be expected to be properly channeled.

It should also be noted that the program is likely to mitigate macrofinancial risks even further: sound practices will be encouraged by the requirements that BNDES will place on the IFIs in terms of applying rigorous portfolio selection and monitoring mechanisms. Past experience with the BNDES has demonstrated its ability to ensure efficient and timely execution of programs of this type, achieving high penetration loan placement levels and delinquency rates that are consistently lower than the average for the loan portfolio of the overall banking system.

Special contractual clauses:

Prior to the first disbursement of program funds, the borrower will provide evidence that the Credit Regulations agreed upon with the Bank have entered into force. Within 12 months after the first disbursement, or once 50% of the loan has been committed, whichever comes first, the borrower and the Bank will conduct a review of compliance with program objectives, and the results obtained. If it is found that the program has not substantially met its objectives, measures will be agreed upon to resolve the problems detected.

Poverty targeting:

While the investments to be financed under the program will create many new jobs in a business segment that employs people primarily from lower-income groups, with the consequent positive impact on the welfare of those groups, the operation is not considered a poverty-targeted investment.

Exceptions to Bank policy:

None.

Procurement:

Not applicable.